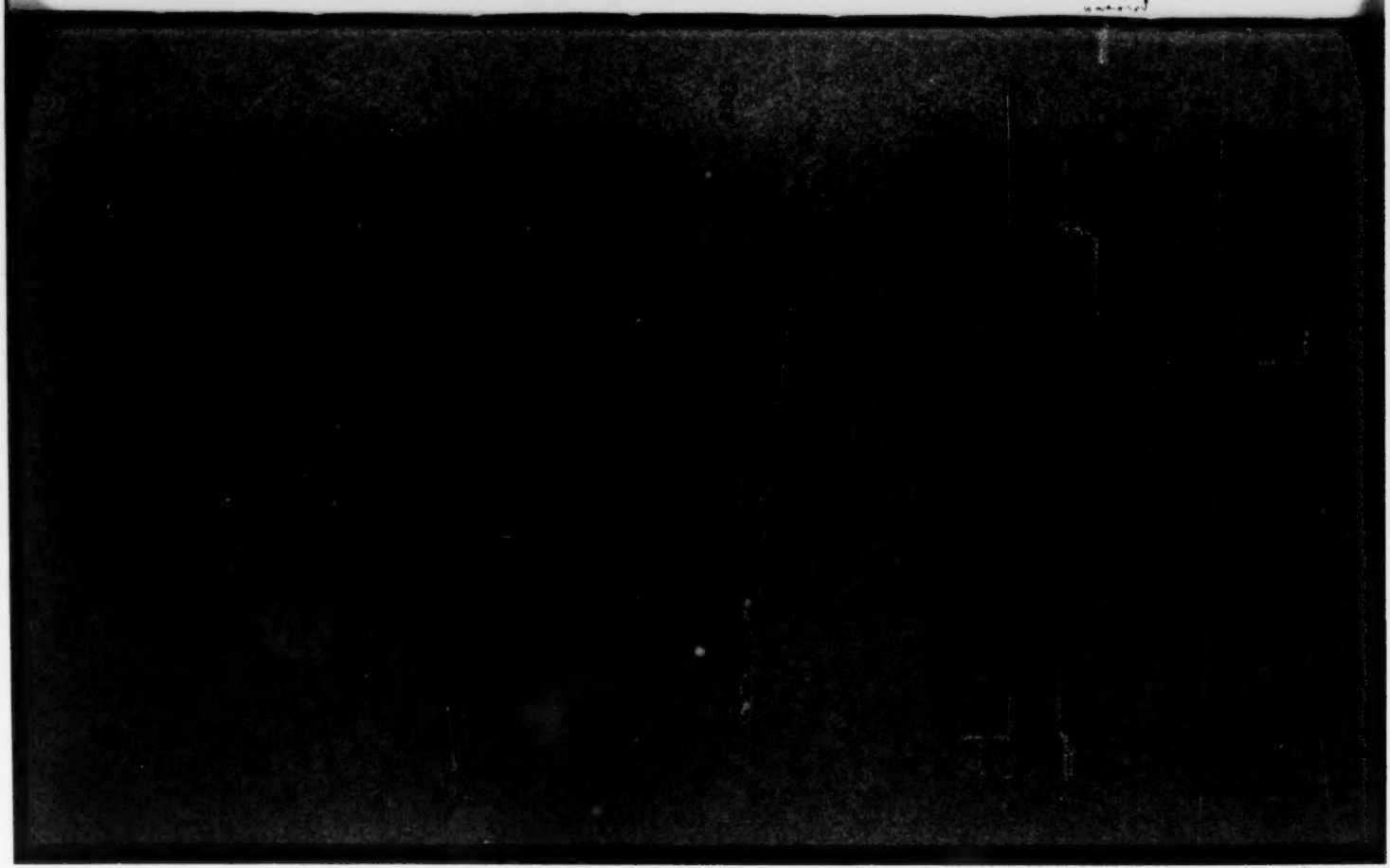

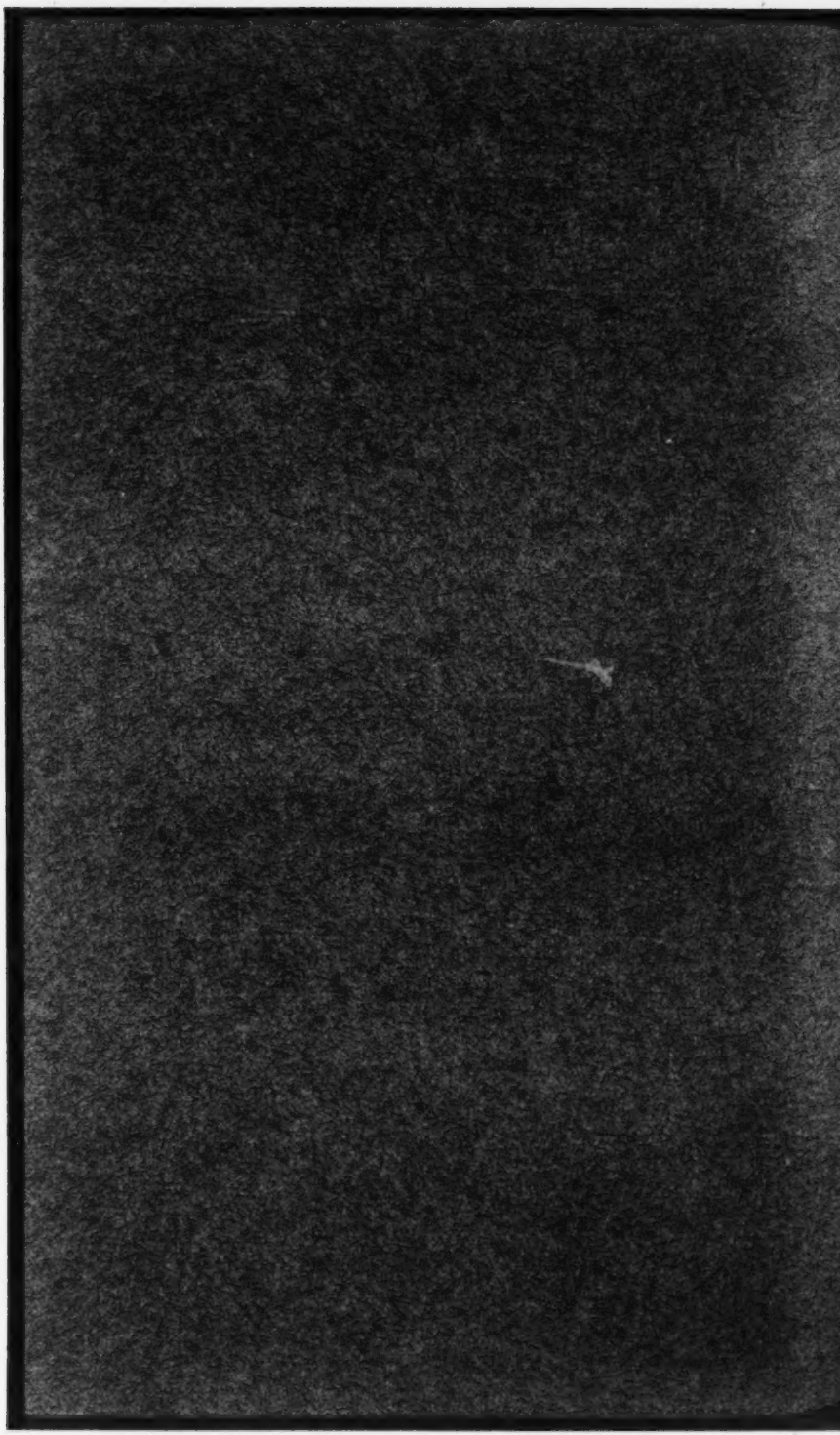

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In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 728

EDNA B. ELIAS, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The majority and minority opinions in the Board of Tax Appeals (R. 52–68) are reported in 41 B. T. A. 1109. The opinion of the Circuit Court of Appeals (R. 145–148) is reported in 122 F. (2d) 171.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered August 21, 1941. (R. 160.) The taxpayer's petition for rehearing was denied August 21, 1941. (R. 159.) The petition for a writ of certiorari was filed November 4, 1941. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

In 1929 the taxpayer created four trusts for the benefit of her children, respectively, naming her husband as trustee with

broad powers of control over the trust properties and reserving the right to revoke the trusts at any time after January 15, 1936. She actually revoked them as of March 4, 1936, whereupon the principal, including capital gains, was paid over to her. Is the taxpayer accountable under Sections 22 (a) or 166 of the Revenue Act of 1934 for the entire net income of the trusts for 1934 and 1935? As a further alternative, is she taxable under section 167 on the capital net gains of the trusts for those years?

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set out in the Appendix, *infra*, pp. 9–17.

STATEMENT

The facts found by the Board of Tax Appeals (R. 53–60) may be summarized as follows:

On July 1, 1929, taxpayer, as grantor, and her husband, Henry Hart Elias, as trustee, executed four trust indentures, in which were designated as the respective beneficiaries Albert Jay, Josephine, Robert Henry, and Catherine Elias, children of taxpayer and her husband. All of the children named are still living, and, in the order stated, were born on September 28, 1924, December 28, 1917, September 17, 1914, and July 21, 1919. Henry Hart Elias continued as trustee until the trusts were terminated. (R. 53.)

The four trusts were substantially similar in all respects material here. The instrument establishing the trust for the benefit of Albert Jay empowered the trustee to invest and reinvest the trust fund of $25,000 and any additions thereto; to receive the income and profits therefrom and, after payment of all lawful charges and expenses, to use and expend the net income, or so much thereof as the trustee in his sole discretion might deem advisable, for the support, education, and maintenance of the beneficiary until he reached the age of twenty-one years, when the trustee was directed to pay

over to him all accumulated and unexpended income. Thereafter, the annual net income was payable to such beneficiary until the death of either taxpayer or the beneficiary, at which time it was provided the trust should terminate and the principal fund then remaining be paid over to taxpayer's husband. In the event the husband should predecease Albert Jay and taxpayer, the net income was payable to such first named beneficiary until his death, with remainder over to taxpayer. Additional provisions relate to the disposition of the corpus or principal fund upon the happening of other contingencies. (R. 54.)

It was further directed that during the lifetime of Henry Hart Elias he should be the sole trustee, with absolute discretion as to the character of investments for the trust fund; that he should have full power to sell the same and reinvest the proceeds in such manner as he might deem advisable, and to do everything in the management and investment of the trust fund and property which an individual could do with his own property. (R. 54–55.)

The trust instrument provided that the term "net income" should not include profits realized upon any sale or exchange of trust property, and that any profits or losses upon such sales or exchanges, including stock dividends and profits realized from subscription rights, or any appreciation or depreciation in value, should accrue to and be borne by the corpus or principal of the trust fund. (R. 55.)

Upon termination of the trust, otherwise than by revocation, the funds and property representing such profits and appreciation were to be paid over to Henry Hart Elias, or, if he should then be dead, to the person to whom the principal of the trust was to be paid under other provisions of the trust. (R. 55.)

It was also provided that if at any time during the minority of the beneficiary the net income of the trust, in the judgment of Henry Hart Elias as trustee, should be insufficient for the proper education, support, and maintenance of the beneficiary,

then such trustee was vested with authority to apply and expend for such purposes, in addition to the net income then available, such part of the principal or corpus of the trust as in his judgment should be advisable. (R. 55.)

It was provided that during the minority of the beneficiary, as long as Henry Hart Elias should be living and competent to administer the trust, the net income should be applied and expended as Henry Hart Elias, in his sole discretion, might determine; but, in the event of the substitution of another trustee during minority of the beneficiary, the net income in its entirety should be paid over by the substituted trustee to the legally constituted guardian of the beneficiary. The trust instrument further provided that the absolute discretion given to Henry Hart Elias as trustee respecting the character of investments of the trust fund should not apply to any substituted trustees; that the powers of the substituted trustees and their successors should be only such as are the usual and customary powers of trustees, with certain exceptions. (R. 55–56.)

The trust instrument authorized the husband, as sole trustee, to borrow from the trust fund, for himself and for his own use, in his own discretion, an amount or amounts not exceeding 80 percent of the trust fund, upon such terms as he might deem advisable, upon payment of interest on the sum borrowed at the rate of four percent per annum. The trust instrument further provided (R. 56):

> The party of the first part, the grantor herein of this trust, hereby expressly reserves to herself the right to modify, alter or entirely revoke this instrument at any time after January 15, 1936, as to all or any part of the trust herein created, without the consent of any Trustee or beneficiary hereunder, upon thirty days' previous notice in writing to the then acting Trustees of the grantor's intention to so modify, alter or revoke this trust indenture. Until said 15th day of January, 1936, this trust is absolutely irrevocable. In the event that

> the grantor at any time shall revoke this instrument, the corpus or principal of the trust fund, together with all accumulations and profits and appreciations, shall be immediately paid over by the Trustees to the party of the first part, the grantor herein, or to such person or persons as she may designate.

In event of the death of Henry Hart Elias before termination of the trust, taxpayer, as grantor, appointed a trust company and a certain individual to act as substituted trustees. She also reserved to herself the right to change any or all of the trustees named in the instrument, and to appoint a successor or successors.[1] (R. 56–57.)

On February 3, 1936, taxpayer executed and delivered to the trustee four notices of revocation, revoking each of the four trusts hereinabove mentioned, which revocation became effective thirty days later, on March 4, 1936. (R. 59.)

On or about the date on which revocation of the trusts became effective, the capital or principal of each trust fund, including net gains on sales made prior thereto, as shown on the balance of the capital account of each trust, was delivered and paid over by the trustee to taxpayer. (R. 59.)

The balance of the income then held in the accounts of the respective beneficiaries, including interest received or accrued and dividends received or declared prior to March 4, 1936, was not paid over or delivered to taxpayer, but was transferred to separate accounts of each of the minor beneficiaries, and the unexpended income of the trust for the benefit of Robert Henry Elias, who had theretofore attained his majority, was paid over to him. When Josephine Elias thereafter attained her majority on December 28, 1938, the balance of the income derived from her trust was paid over to her. (R. 59.)

The husband never exercised the power conferred on him to borrow money from any of the four trusts. (R. 59.)

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[1] The Board omits from its findings the provision of the trust instruments (R. 122, 131) to the effect that such successors were to have all the powers of the trustees originally appointed.

The Commissioner included in the grantor's taxable income both the ordinary net income and the capital net gains of the trusts for 1934 and 1935. Upon review the Board held that the taxpayer was accountable for the capital gains but not for the ordinary income of the trusts. Both parties appealed and the court below affirmed the order of the Board on the taxpayers appeal and reversed it on the Commissioner's appeal.

ARGUMENT

1. The court below, following its own prior decisions in *Commissioner* v. *Barbour*, 122 F. (2d) 165, and *Commissioner* v. *Woolley*, 122 F. (2d) 167, held that in "short-term" trusts, which keep the income among members of a family living in amity and dependence, the failure of the settlor expressly to reserve control of the trust property during continuance of the trust [2] is not an important factor, particularly where, as here, the trustee was the husband of the settlor who would not be likely to disregard her wishes in respect to management. We submit that the decision is correct and falls within the scope of this Court's rulings that trusts of this character which are merely temporary reallocations of income within an intimate family group, do not operate to relieve the settlor from the income tax. *Helvering* v. *Clifford*, 309 U. S. 331; *Hormel* v. *Helvering*, 312 U. S. 552; *Helvering* v. *Fuller*, 310 U. S. 69, 76; *Helvering* v. *Horst*, 311 U. S. 112; *Helvering* v. *Eubank*, 311 U. S. 122; *Harrison* v. *Schaffner*, 312 U. S. 579. In the circumstances, we submit that there is no merit to the taxpayer's contention (Pet. 10; Br. 17–23) that the decision below conflicts with *Helvering* v. *Clifford*, *supra*.

[2] The court below did not consider it necessary to pass upon the Government's contention that the settlor had power, under the trust terms, to change any trustee and appoint a successor, such successor to have the same powers as his predecessor. (R. 122, 131; but see R. 117, 120, 127, 129–130.)

2. The tax here involved may also be sustained under Section 166 of the Revenue Act of 1934 (Appendix, *infra*), which provides for the taxation to the grantor of trust income where he has at any time the power to revest in himself title to the trust corpus. Since the grantor in the instant case reserved the right to revoke the trusts and revest in herself title to the trust properties at any time after January 15, 1936, the statute is clearly applicable and it is immaterial that her right might have been defeated by the happening of certain events such as her death prior to that date which did not in fact occur. The situation here is substantially similar to that in *Helvering* v. *Dunning*, 118 F. (2d) 341 (C. C. A. 4th), certiorari denied, October 13, 1941, No. 114, present Term. There, as here, the trusts were created prior to the enactment of Section 166 of the Revenue Act of 1934; and the taxpayer's argument (Br. 24–29) that the law, as so amended, cannot constitutionally be applied in respect to such trusts is clearly unsound. *Reinecke* v. *Smith*, 289 U. S. 172, 175; *Kraft* v. *Commissioner*, 111 F. (2d) 370 (C. C. A. 3d), certiorari denied, 311 U. S. 671. The case of *Corning* v. *Commissioner*, 104 F. (2d) 329 (C. C. A. 6th), relied upon by the taxpayer (Br. 24), is distinguishable on the ground that the power there was contingent upon the death of the grantor's father, while the power here was subject to no such contingency. Moreover, in a later decision (*Altmaier* v. *Commissioner*, 116 F. (2d) 162, 165, certiorari denied, 312 U. S. 706), the *Corning* case was expressly disapproved by the Sixth Circuit itself.

3. The capital gains are also taxable under Section 167 of the Revenue Act of 1934 (Appendix, *infra*), which provides that where any part of the income of a trust is, or in the discretion of the grantor or of any person not having a substantial adverse interest may be, held or accumulated for future distribution to the grantor, then such part of the income of the trust shall be included in computing the net income of the grantor. Here the trustee was required to add the capital gains to corpus and upon revocation they were

payable to her; she thus had command over them and in fact received them in 1936 when she revoked the trusts. The Commissioner's position here is supported by decisions such as *Kent* v. *Rothensies*, 120 F. (2d) 476 (C. C. A. 3d), certiorari denied, October 13, 1941, No. 537, present Term; *Altmaier* v. *Commissioner, supra*, and *Graff* v. *Commissioner*, 117 F. (2d) 247 (C. C. A. 7th). Cases cited by the taxpayer (Br. 29–31), such as *Commissioner* v. *Waterbury*, 97 F. (2d) 383 (C. C. A. 2d), certiorari denied, 305 U. S. 638; *United States* v. *Stroop*, 109 F. (2d) 891 (C. C. A. 6th), and *Commissioner* v. *Grosvenor*, 85 F. (2d) 2 (C. C. A. 2d), were decided under provisions of the 1928 law which are materially different from Section 167 of the Revenue Act of 1934, applicable here. Moreover, those decisions were rendered prior to *Helvering* v. *Clifford, supra*, and they must therefore be viewed now in the light of that decision.

CONCLUSION

The decision below is correct; there is no conflict; the petition should be denied.

Respectfully submitted.

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NOVEMBER, 1941.